

DEPARTMENT OF BUSINESS OVERSIGHT*Ensuring a Fair and Secure Financial Services Marketplace for all Californians*

Jan Lynn Owen
Commissioner of Business Oversight

June 6, 2017

Re: _____ – Opinion Request

Dear _____:

Thank you for your letter dated February 28, 2017 (which was included with the letter from _____ dated March 1, 2017), as supplemented by your letters dated March 30, 2017, April 14, 2017, and May 3, 2017. _____ (“_____”) has requested confirmation that the California Money Transmission Act (“MTA”) does not apply to the payment services that _____ provides in the _____ payment network. For the reasons discussed below, the Department of Business Oversight (“Department”) concludes that the MTA does apply to _____ activities.

BACKGROUND

_____ is headquartered in Colorado and registered as a money service business with the Financial Crimes Enforcement Network, Department of Treasury (“FinCEN”).

_____ operates a mobile payment solution in the form of an e-wallet called _____ (“Network”). According to the _____ Member and Merchant Agreement (“Agreement”), participants in the Network are either a “Member” or a “Merchant.” A Member is a consumer, and a Merchant is a seller of goods or services.

Members of the Network exchange U.S. currency for _____ Network Credit (“Network Credit”). _____ issues the Network Credit. The funds received from Members are held at banks in _____’s name. The value of the Network Credit corresponds to the value of the U.S. currency used to acquire the Network Credit. A Member can use Network Credit to purchase goods and services from Merchants that accept Network Credit. Merchants are also able to use Network Credit to purchase goods and services from

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other Merchants. In those transactions, such purchasing Merchant acts in the capacity of a Member. As discussed in more detail below, Members and Merchants can also redeem Network Credits for cash.

Members

To become a Member of the Network, a person must undergo a routine background check similar to that which occurs when opening a bank account. The prospective Member must clear the Office of Foreign Asset Control screening and otherwise comply with Bank Secrecy Act requirements. Upon registration with the Network, a Member is assigned an account by _____. According to the Agreement, the account is an electronic account for "Network Credit issued and managed by _____."

A Member can load Network Credit in his or her account through payments by cash, credit card, debit card, Automated Clearinghouse Transfers ("ACH"), or payroll. By default, one dollar of Network Credit is collateralized with and pegged to one U.S. dollar. Thus, if a Member exchanges \$50.00 U.S. dollars for Network Credit, the Member's account will increase by a value of \$50.00 of Network Credit.

Merchants

Participating Merchants must pass a more detailed compliance background check than required for Members. Typical merchants include any cash intensive business such as retail sales, auctions, and cannabis sales. Also, government services such as bail bonds, licenses, state and county fairs are likely users of the Network. A benefit of the Network is to eliminate or reduce cash losses from sales and to improve the financial accountability of vendors.

According to the terms of the Agreement, the Merchant must directly provide the product or service to a Member for any Network Credit it accepts. The Merchant is the party that delivers the merchandise or completes a service to the customer. The Merchant is wholly responsible for Network Credit returns and disputes submitted by Members or Merchant's customers.

Redemption of Network Credit

Both Members and Merchants may convert Network Credit to cash at any _____ Financial Center/kiosk or at participating Merchants or redemption centers. Members and Merchants can also redeem Network Credits online and send the funds to their own bank account via ACH. Alternatively, they can request that an electronic check to be sent to a non-member, e.g., to pay a utility bill. When a Member or Merchant requests that funds be transferred, _____ directs its financial institution at which the funds are being held, to transfer the funds. In addition, Members and Merchants can transfer Network Credit to any other Member with an Account.

MONEY TRANSMISSION ACT

The MTA provides that a person shall not engage in the business of money transmission in California unless the person is licensed or exempt from licensure under the MTA, or is an agent of a person licensed or exempt from licensure.¹ Financial Code section 2003, subdivision (q) defines “money transmission” in relevant part as selling or issuing stored value.

Financial Code section 2003, subdivision (x) defines “stored value” as monetary value² representing a claim against the issuer³ that is stored on an electronic or digital medium, and that is intended and accepted for use as a means of redemption for money or monetary value or payment for goods or services (“Open Loop stored value”). The term does not include any stored value that is only redeemable by the issuer for goods or services provided by the issuer or its affiliate (“Closed Loop stored value”).⁴

_____ asserts that it does not issue stored value for a few reasons. _____ argues that “it issues no value.” _____ contends that it merely “exchanges its Member’s cash and issues an equivalent credit,” fully collateralized by _____’s insured deposits. _____ also asserts that it is not issuing stored value because funds received from Members are held and owned by _____. _____ states that the actual transmission of funds is completed by _____’s bank or other financial institution, not by _____.

The Department has considered _____’s arguments, and we disagree. For the reasons discussed below, the Department concludes that Network Credit is Open Loop stored value, and therefore, the issuance of Network Credit is subject to the MTA.

Monetary value

Financial Code section 2003, subdivision (l) defines “monetary value” to mean a medium of exchange, whether or not redeemable in money. Network Credit is a form of monetary value, which has a default value corresponding to the U.S. dollar. For example, \$50.00 of Network Credit is worth \$50.00 U.S. dollars. Members may use Network Credit to purchase goods and services from Merchants.

¹ Fin. Code, § 2030, subd. (a).

² “Monetary value” means a medium of exchange, whether or not redeemable in money. Fin. Code, § 2003, subd. (o).

³ “Issuer” means the entity that is liable to the holder of the stored value and has undertaken or is obligated to pay the stored value. Fin. Code, § 2003, subd. (l).

⁴ Fin. Code, § 2003, subd. (x).

Issuer

_____ is the issuer of Network Credit. Financial Code section 2003, subdivision (l) defines an “issuer” to mean the entity that is liable to the holder of the stored value and has undertaken to pay the stored value. Network Credit represents a claim against _____ because _____ is liable to the Member for his or her Network Credit, and _____ has undertaken to pay the value of the Network Credit. For example, the Agreement provides that a Member “may convert the Network Credit in your Account to cash by redeeming your Network Credit with _____ for cash.”

Electronic or digital medium

The Financial Code provides that stored value means monetary value that is “stored on an electronic or digital medium.”⁵ Network Credit is “stored on an electronic or digital medium.” Upon registration with the Network, a Member is assigned an account by _____. According to the Agreement, the “[a]ccount is an electronic account” for Network Credit issued and managed by _____.

Redemption

The Financial Code provides that stored value is “intended and accepted for use as a means of redemption for money or monetary value or payment for goods or services.”⁶ For purposes of the Financial Code, stored value does not include Closed Loop stored value; that is, stored value that is only redeemable by the issuer for goods or services provided by the issuer or its affiliate.⁷

According to the Agreement, Network Credit is intended and accepted for use as a means of redemption for money or payment for goods or services. Members and Merchants may convert Network Credit to cash at any _____ Financial Center/kiosk or at participating Merchants or redemption centers. Members and Merchants can also redeem Network Credits online and send the funds to their own bank account via ACH. Or, they can transfer Network Credit to any other Member with an Account. Members can even request that an electronic check to be sent to a non-member, e.g., to pay a utility bill. Members may also use Network Credit to purchase goods and services from Merchants. These features of Network Credit are typical characteristics of Open Loop stored value.

In addition, Network Credit does not meet the definition of Closed Loop stored value. In order to qualify as Closed Loop, the stored value must be only redeemable by the issuer for goods or services “provided by the issuer or its affiliate.”⁸ However, _____ does not

⁵ Fin. Code, § 2003, subd. (x).

⁶ *Id.*

⁷ *Id.*

⁸ *Id.*

provide any of the goods or services that Network Credit can be used to purchase. The terms of the Agreement expressly provide that the Merchant must directly provide the product or service to a Member for any Network Credit it accepts. Furthermore, Merchants are not affiliates of _____. The Agreement states that Members, Merchants, and _____ are “independent contractors, and will not be considered agents, servants, joint ventures, or partners of one another.” Therefore, Network Credit is not Closed Loop stored value.

_____ also argues that it is not engaging in money transmission because funds received from Members are held and owned by _____. This is not a basis for an exemption from the MTA. All money transmitter licensees own customer funds that they receive. Such funds appear as an asset on a licensee’s balance sheet. Licensees simply have a corresponding transmission liability. In fact, in order to qualify as an eligible security,⁹ a licensee must own the eligible security.¹⁰ Cash and deposits in insured banks are standard forms of eligible securities.¹¹ Thus, the fact that _____ holds Member funds in its own name only further supports a finding that _____ would be engaging in money transmission.

Lastly, _____ states that when Network Credit is redeemed, the actual transmission of funds (e.g., to a Member's bank account or an electronic check to a non-Member) is completed by _____’s bank or other financial institution, not by _____. In other words, when a Member wants to redeem Network Credit, _____ requests its bank to complete the transaction. _____ submits that this fact supports a finding that _____ is not conducting money transmission. We disagree. All money transmitter licensees are dependent on their financial institutions in which they maintain their accounts to complete the settlement process of transmittal funds. That is the function of the financial institution. The crucial issue is whether those accounts are held in the licensee's name or the financial institution's name. If the accounts are held in the licensee's name, as discussed above, such licensee is engaging in money transmission, irrespective of the fact that the licensee's financial institution is performing the funds settlement process.

CONCLUSION

Based on the facts described and the reasons discussed above, the Department concludes that the MTA does apply to _____’s _____ Network activities. Therefore, _____ should not conduct these activities in California unless and until it has obtained a license from the Department.

⁹ A licensee is required at all times to “own eligible securities” having an aggregate market value of not less than the aggregate amount of outstanding money transmission obligations. Fin. Code, § 2081, subd. (a).

¹⁰ See Fin. Code, § 2084.

¹¹ Fin. Code, § 2082.

This opinion is based solely on the facts as represented in your correspondence, and may change if any of the facts or circumstances under which _____ provides products or services are altered in the future.

If you have any questions, please contact me at _____.

Sincerely,

Jan Lynn Owen
Commissioner
Department of Business Oversight

By

Jennifer L.W. Rumberger
Senior Counsel